

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Frank Avila
Office of Appeals
Field Operations West, Area 9, Team 8

from: Carol P. Nachman
Senior Technician Reviewer
(Procedure & Administration)

subject: Interest Netting and Abatement of Interest

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

T =
R =
TY1 =
TY2 =
TY3 =
TY4 =
TY5 =
TY6 =
D1 =
D2 =
D3 =
D4 =
D5 =
D6 =
D7 =

D8 =
D9 =
D10 =
D11 =
D12 =
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X1 = (\$)
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X4 = (\$)
X5 = (\$)
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X7 = (\$)
X8 = (\$)
X9 = (\$)
X10 = (\$)
X11 = (\$)

ISSUE

Whether excess underpayment (or deficiency) interest that a taxpayer has paid but which is not “payable” under I.R.C. § 6601 is subject to net rate netting under section 6621(d).

CONCLUSION

Excess underpayment interest that is not payable, whether or not paid, is not available for interest netting under section 6621(d).

FACTS

a. Overview

This case involves netting of overpayment and underpayment interest. The taxpayer, T, made a request under section 6621(d) for interest netting covering four years, two of which are in dispute. The Service processed the request, and after netting, issued a refund to the taxpayer for one (the earlier) of the two disputed years and no refund for the other year.

Detailed information is set out in the sections that follow, but the basic background for each of the two years at issue is that there were unpaid taxes due on which underpayment interest was imposed, followed by overpayments that earned interest until refunded. More specifically, after the returns were filed, examinations determined deficiencies in tax that were timely assessed under statute extensions. The taxpayer made advance and follow-on payments toward the deficiencies. These remittances, plus prior credits and estimated tax payments, paid the accounts in full, including accrued interest.

Later, overpayments were generated by NOL carrybacks. The overpayments were refunded to T with interest. The Service used a date later than the correct one in determining when the loss carrybacks were effective as credits, with the result that less underpayment interest was abated than should have been (i.e., the taxpayer overpaid interest).

The point of contention is over how this excess (overpaid) underpayment interest should be treated for interest netting purposes. T contends that the Service erred in its computations by excluding the excess interest from the net rate adjustments and if corrected, the taxpayer is entitled to a larger refund than it received. The Service, on the other hand, has determined that any excess underpayment interest paid cannot be the basis for an additional refund because the period of limitations on claims for refund or abatement of underpayment interest had expired as of the time of the request for netting.

b. *The Netting Claim*

T's representative, R, submitted to the Service a claim dated D1 (received on D2), on Form 843, *Claim for Refund and Request for Abatement*, with attached letter, for interest netting under section 6621(d) for tax years TY1 through TY4. T requested that the Service apply a net rate of zero to overlapping periods of underpayment interest and overpayment interest for the four tax years. As to TY2 and TY3, T requested refunds (after netting and with interest) of \$X1 and \$X2, respectively. On D3, the Service, through one of the Complex Interest Teams in Ogden, sent T a letter, with a copy to R, informing T that the Service was allowing interest netting for TY1 through TY4, resulting in a total refund of \$X3. Enclosed with the letter was a CD with detailed interest computations.

Although not recited in the letter, the Service's computations effectively reduced the refund amounts that T claimed for TY2 and TY3 by doing a full re-computation of interest for these periods with what the team termed a "write off" of any reduction in underpayment interest that was outside the period of limitation for an abatement claim. The computations for TY2 also included an adjustment on the overpayment side for an amount of interest, \$X4, that the interest specialists determined was previously

refunded to T in error, though the period of limitation for an erroneous-refund action had expired.¹ In other words, certain amounts of interest were not available for netting.

T, through R, objected to this approach, at least as to the write-off, in a D4, letter to the Service. T's apparent position is that in the netting computations, the excess underpayment interest should not be deducted from the total underpayment interest assessed and paid for TY 2 and TY 3. The letter characterizes the issue as whether the write-off of amounts that "can be used for netting purposes . . . on the basis that [the amounts are] . . . barred by statute" limited the extent of netting to which T was otherwise legally entitled. T requested that the Service redo the computations in a different way:

In order to correctly net . . . , (1) all of the transactions that posted through [D5] [which is roughly when the accounts went from underpaid to overpaid status without regard to the carrybacks] must be put into one computation on the . . . interest software and (2) the remaining carryback transactions and subsequent refunds should be put into a separate computation.

* * * *

It remains our position that it was incorrect to perform a full recomputation on the . . . accounts and that instead the deficiency portion and the refund portion should have been separated so as to obtain a correct interest-netting calculation.^[2]

We interpret this language as claiming that all deficiency interest running to the underpayment end-date should be calculated separately from the credit interest resulting from the carrybacks, in order to give T the full benefit of netting, rather than computing all of the transactions together, which adjusts downward the deficiency interest to be netted. The letter asserts that when interest netting is computed in the right way, T is due additional refunds of \$X5 (for TY2) and \$X6 (TY3).³

c. Carrybacks & Excess Underpayment Interest

The NOL carrybacks, which the Service evidently credited with the wrong effective dates (leading to the complication in this case), were made after, but the loss year was before, the TY2 and TY3 liabilities, including interest, were full paid. Specifically, on D6, T paid an assessed deficiency plus interest for TY2, and on D7, the company paid its liability for TY3. The deficiencies were assessed on D8, which was within the

¹ Absent fraud or a misrepresentation of material fact, an erroneous refund action must be commenced within two years of the refund. I.R.C. § 6532(b).

² It is unclear why the D5 date was used, given that the payments which brought the accounts into credit status posted on D6 and D7. We assume it is an error.

³ T has not objected to the interest-netting computations for TY1 or TY4.

assessment period as extended by agreement to D9. An NOL carryback from TY5 to TY2 was posted as of D10, and another NOL carryback from TY5 to TY3 was posted as of D11.⁴ As a consequence of the carrybacks, the Service issued refunds to T for TY2 and TY3. It seems the refunds did not include the amount of deficiency interest that accrued from the filing date of the loss year, D12, to the dates the interest was later paid, D6 (for TY2), and D7 (TY3).⁵ For TY2 the accrued interest was \$X7, and for TY3 the accrued interest was \$X8.

d. Appeal

As part of its D4, response to the Service's action on the netting claim, T requested reconsideration, including if necessary, review by Appeals.⁶ In a D14, letter to T (copy to R), the Service treated T's netting claim as partially a "request for abatement of interest" (namely, the excess, overpaid interest) and denied the request because the refund period for TY2 and TY3 was expired. The letter informs T that the case has been referred to Appeals. T and R continue to assert that "the IRS's computation was incorrect" and have requested a conference with Appeals to press their case.

LAW AND ANALYSIS

a. Purpose of Netting

The purpose of interest netting is simply to relieve a taxpayer from owing more interest than the Service owes the taxpayer on equal amounts of money for equal lengths of time. There can be a substantial difference in the rate of interest under section 6621(a) that is payable on underpayments and allowable on overpayments. Prior to the enactment of section 6621(d) in 1998, because the interest rate on underpayments was higher than that on overpayments,⁷ taxpayers with overlapping periods of underpayment and overpayment interest often were assessed a net interest charge, even if the amounts of the underpayment and overpayment were the same. H.R. Conf.

⁴ The D4 letter is unclear as to whether the same NOL was carried back to both TY2 and TY3 or if two different NOLs were carried back, one to TY2 and one to TY3.

⁵ I.R.C. § 6601(d)(1) provides that when a carryback of an NOL or a net capital loss reduces or eliminates a deficiency in tax for a prior year, the taxpayer remains liable for underpayment interest on the reduced or eliminated amount from the last date prescribed for payment of the tax to the filing date for the loss year. The taxpayer is not liable for interest on the reduced or eliminated after the filing date of the loss year, and any interest assessed after that date is abated, refunded, credited, or otherwise applied to the taxpayer's benefit.

⁶ Pursuant to IRM 8.5.1.6(1) (02-01-2007), "Taxpayers may ask Appeals to reconsider a claim disallowed by an area office or an IRS Campus site."

⁷ The underpayment rate remains higher than the overpayment rate for corporate taxpayers. I.R.C. § 6621(a)(1)-(2).

Rep. No. 105-599, at 256 (1998). Congress acted to correct this difference with section 6621(d), which provides for a net interest rate of zero on overlapping periods of underpayment interest and overpayment interest with regard to the same taxpayer.⁸ Specifically, Congress provided in section 6621(d) that to the extent “interest is payable under subchapter A [sections 6601-6603] and allowable under subchapter B [sections 6611-6612] on equivalent underpayments and overpayments by the same taxpayer of tax imposed by this title, the net rate of interest under this section on such amounts shall be zero for such period.”

b. *Timing Requirements*

Section 6621(d) is effective, generally, for periods of overlap beginning after July 22, 1998, but it is also applicable to prior periods if:

- (1) the controlling period of limitation for a claim for refund or credit of the overpayment interest was open on July 22, 1998;
- (2) the limitations period for a claim for additional interest on the overpayment was also open on July 22, 1998;
- (3) the taxpayer reasonably identifies and establishes the overpayment and underpayment periods subject to netting; and
- (4) the taxpayer requests netting not later than December 31, 1999.

RRA '98, Pub. L. No. 105-206, § 3301(c)(2), 112 Stat. 685, 741 (1998) (Special Rule), as amended by Pub. L. No. 105-277, § 4002(d), 112 Stat. 2681-1, 2681-906 (1998); Rev. Proc. 99-43, 1999-2 C.B. 579, §§ 3.01, 4.01. A taxpayer's request for interest netting submitted after December 31, 1999, is nevertheless timely if either the limitations period as to underpayment interest or the period as to overpayment interest is open after December 31, 1999, in addition to both being open as of July 22, 1998. In all cases, both periods must have been open on the date of enactment for section 6621(d) to apply. *Federal Nat'l Mortgage Ass'n v. United States*, 379 F.3d 1303 (Fed. Cir. 2004).

With regard to T, the period relative to underpayment interest as well the period relative to overpayment interest was open for both TY2 and TY3 on July 22, 1998. The periods were also open for each year after December 31, 1999. As to underpayment interest, the period during which a taxpayer may file a claim for credit or refund of underpayment interest is ordinarily either three years from the date the return was filed (which for T's TY2 return was D15, and for the TY3 return, D16) or two years after the interest was

⁸ As explained in the IRM, “[t]he reference in the provision that the ‘net rate of interest shall be zero’ does not mean the IRS will not charge or allow interest,” only that the rates of interest will be equalized so that they net to zero. IRM 20.2.14.6.1(1) (09-20-2006).

paid (D6 and D7), whichever is later. I.R.C. § 6511(a); Rev. Proc. 99-43, § 4.02(1). There are special rules, however, in the case of a carryback or an extension on assessment of tax, both of which are present in T's situation. Because the rule for extensions provides the longest period, we consider it to be controlling.⁹ Under this rule, if a taxpayer and the Service agree, during the period that is three years after a return is filed or two years after tax for the period is paid (whichever is later), to extend the period for assessment of tax, then the period for a refund claim ends no earlier than six months after the expiration of the extended assessment period. I.R.C. § 6511(c)(1). By agreement (presumably reached sometime during the normal two- or three-year period for a refund claim), the extended assessment date for both TY2 and TY3 was D9. Six months after D9 was D17 (or thereabout), which is later than July 22, 1998, and later than December 31, 1999.¹⁰

As to overpayment interest, the period during which T could make a claim for additional overpayment interest was six years from the date the Service allowed the refunds, D10 for TY2 and D11 for TY3. 28 U.S.C. §§ 2401, 2501; Rev. Proc. 99-43, § 4.02(2); Rev. Rul. 56-506, 1956-2 C.B. 959. The six years did not end until D18 and D19.¹¹

Under the facts described above, T met the conditions for the netting of interest for TY2 and TY3. As long as the limitations period as to each type of interest was open as of July 22, 1998, which by all appearances they were, and as long as at least one of the limitations periods for either type was open after December 31, 1999, which also appears to be true, then the underpayment and overpayment interest is within the retroactive reach of section 6621(d). It does not matter—for the allowance of a claim as timely—that the period to claim a refund of underpayment interest was closed when the netting claim was filed, as the overpayment interest period was still open.

In terms of how netting is to be applied, though, the open or closed status of the refund period has an effect. If the refund period for underpayment interest is still open when a netting claim is filed, then the net rate of zero is applied by lowering underpayment interest (and refunding or crediting the difference, with interest, if necessary). Rev. Proc. 99-43, § 4.04(1). If the period is closed when the claim is filed, but the period for paying additional overpayment interest is open, then the net rate of zero is applied by increasing overpayment interest (with a refund or credit). Rev. Proc. 99-43, § 4.04(2).

⁹ Otherwise, the carryback rule would apply pursuant to section 6511(d)(2)(A), which provides that the refund period shall be three years after the due date of the return for the loss year, unless the extension-agreement rule provides a longer period.

¹⁰ Even measuring the period using one of the other two standards—the default rule or the carryback rule—the period was open on July 22, 1998. The dates on which T paid the underpayment interest were not more than two years before July 22, 1998. Likewise, T's return for the loss year, TY5, was due no later than D12, less than three years before July 22, 1998. The return must have been a short year return for the D13 period (likely because of a change to the annual accounting period) and thus due on D12. I.R.C. § 443(a); Treas. Reg. §§ 1.443-1(a)(1), 1.6072-2(a).

¹¹ The same six-year period applied for filing suit. Any action brought now is time-barred.

As explained, the period to file a timely claim for refund of underpayment interest for TY2 and TY3 was closed when T filed its netting claim, while the period for paying additional overpayment interest was open. Therefore, for TY2 and TY3, the net rate of zero should have been, and was, applied by increasing overpayment interest owed to T and refunding the result. T contends that the increase to overpayment interest should have been larger.

c. Amounts to be Netted

The universe of interest *potentially* available for netting is whatever interest accrues during the respective underpayment and overpayment periods. Interest on an underpayment of tax runs from the last date prescribed for payment of the tax to the date paid. I.R.C. § 6601(a). The last date prescribed for payment of tax is the date fixed for filing an associated return, without regard to extensions of time to file. I.R.C. § 6151(a); Treas. Reg. § 301.6611-1(h)(2). By that measure, interest on T's underpayments ran from D15 to D6 for TY2, and from D16 to D7 for TY3.

Overpayment interest runs, in the case of a refund, from the overpayment date to a date preceding the issuance of the refund by not more than 30 days. I.R.C. § 6611(b)(2). An overpayment occurs on the payment date of an amount that exceeds the tax liability. *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947) (defining "overpayment" as "meaning any payment in excess of that which is properly due"); Treas. Reg. § 301.6611-1(b). When an overpayment results from a carryback, the overpayment date—or credit availability date—is generally the return due date for the year resulting in the carryback, or, if the return is filed late, the date of filing. I.R.C. § 6611(f)(3). For IMF accounts, overpayment interest stops 13 days before the refund; for BMF accounts, interest stops nine days before the refund. IRM 20.2.4.7.1.1(1) (03-01-2002). Once an overpayment is refunded, interest on the overpayment is no longer allowable. *Godfrey v. United States*, 997 F.2d 335, 336-37 (7th Cir. 1993).

In T's case, the overpayment date for both TY2 and TY3 was D10—the filing date of the return for the loss year. The refunds were made on D8 and D9, so the overpayment interest periods ended nine days before D8 and D9.

The total amount of TY2 underpayment interest charged to, and paid by, T (from the interest start-date to end-date) was \$X9. The total amount of TY3 underpayment interest was \$X10. T claims that these amounts can be netted against overlapping overpayment interest. The automated computations run by the Service, however, reduced the totals to account for overcharged interest, X7 and X11.¹² We conclude that such corrections to underpayment interest available to be netted are proper.

¹² For reasons unclear to us, the reduction (or "write off") for TY3 year was only X11, instead of X8, which was the amount of interest that accrued from the availability date of the carryback (at least in the Service's computations). In any case, the taxpayer received no netting benefit as to TY3.

A threshold requirement of section 6621(d) is that underpayment interest is “payable” and overpayment interest is “allowable.” If interest is not “payable” or “allowable,” then it is not interest as described in section 6621(d). *Shriners Hosps. for Crippled Children v. United States*, 862 F.2d 1561, 1563 (Fed. Cir. 1988) (“Tax and interest payments are creatures of statute, and such statutory provisions are to be given their plainest reasonable meaning, in implementation of the discernible intent of Congress.”). Notably, the section does not contain (or imply) qualifying language for underpayment interest other than “payable” (under section 6601), such as “assessed,” “accrued,” “paid,” “imposed,” etc. Nor does the section provide that any overpayment interest other than “allowable” interest under section 6611, such as “allowed,” “accrued,” or “credited” interest, is capable of being netted. Underpayment interest is payable under section 6601 from the tax due date to the payment date. *FleetBoston Fin. Corp. v. United States*, 483 F.3d 1345, 1351 (Fed. Cir. 2007) (section 6601 “imposes interest for any period during which an amount of tax is both due and not paid”). Determining how much interest is owed—meaning, how much is “payable”—is a three-part formula of time, principal, and rate. If any one or more of the three, such as time, is incorrect, the interest amount will be too high or too low. Thus, if underpayment interest continues after the date of full payment, then the interest amount will be too much. But only the amount up to the payment date is “payable” under section 6601, while the difference is not. The unpayable amount is excess interest that the affected taxpayer is entitled to have abated and, if already paid, refunded or credited elsewhere as an overpayment. Similarly, overpayment interest is “allowable” under section 6611 only from the date of the overpayment to either the refund date (minus the 9- or 13-day “back-off” period) or the credit transfer date. If the Service allows too much interest, the excess is not “allowable.”

We interpret section 6621(d) as applicable only to underpayment interest that is strictly “payable.” See *Library of Congress v. Shaw*, 478 U.S. 310, 318 (1986) (interest provision strictly construed); *Miller v. Alamo*, 992 F.2d 766, 767 (8th Cir. 1993). Further, only “allowable” overpayment interest can be netted under section 6621(d). See *Computervision Corp. v. United States*, 62 Fed. Cl. 299, 329-32 (2004) (holding that section 6621(d) interest netting did not apply because overpayment interest was not “allowable” on credit elect overpayments or on overpayments refunded within 45 days of the filing of the refund return), *aff’d*, 445 F.3d 1355 (Fed. Cir. 2006). Indeed, Rev. Proc. 99-43 states in section 3.02(2) that it does not apply to “an overpayment or underpayment for any period during which interest on the overpayment or underpayment was not *allowable* or *payable* by law (e.g., the 45-day interest disallowance rule under § 6611(e)).”

T’s TY2 and TY3 underpayment interest that was written off for netting purposes was not interest “payable” under section 6601 as of the time of the netting claim. It is true that interest on the deficiencies in both years was payable up to the point the balances were paid off. When the taxpayer later chose to carryback NOLs, however, the amount of interest that had been payable under section 6601 (and was in fact paid) was reduced. Section 6621(d) allows for netting of interest that “*is payable*,” not interest that

was payable at one time. The unpayable interest should have been abated and returned to T, and T could have filed a timely administrative refund claim. Not having done so, T may not use netting to obtain a refund outside of the limitations period.¹³

Because certain amounts of underpayment interest were not “payable,” it was appropriate for the Service to correct the underpayment interest available for netting (to do the write-offs). Corrections of this sort appear to be contemplated by the revenue procedure, which explains that amounts submitted in a taxpayer’s computations are not only subject to verification but “may be subject to adjustment for purposes of computing the net interest rate of zero pursuant to § 6621(d).” Rev. Proc. 99-43, § 5.05; *see also* IRM 20.2.14.6.4.1(4) (when applying interest netting by adjusting overpayment interest (because the period for refund of underpayment interest is closed), “and the underpayment interest is not correct,” then “[p]erform the net rate adjustment based on the correct amount of underpayment interest”).¹⁴

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Please call (202) 622-4940 if you have any further questions.

¹³ Even if the period remained open, we would still consider the excess interest to be not “payable” in connection with netting.

¹⁴ Although T does not seem to challenge any correction to overpayment interest for TY2, under our analysis, the excess overpayment interest that was erroneously refunded to T would not be “allowable” interest available for netting. Like the difference between interest that is “payable” and interest that has been overpaid but is not “payable” (for which a taxpayer may have a separate right to reclaim), limiting netting to “allowable” overpayment interest is independent of whether the Service may recapture excess overpayment interest, such as through an erroneous refund action or common law right of setoff.